PMA

PROFESSIONAL MANAGERS ASSOCIATION

TESTIMONY ON

DEVELOPMENT OF A NEW RETIREMENT PLAN

FOR FEDERAL EMPLOYEES SUBJECT TO SOCIAL SECURITY

BEFORE

COMMITTEE ON POST OFFICE AND CIVIL SERVICE

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BY

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23 APRIL 1985

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Thank you for the opportunity to testify. My name is Michael J. Riselli and I am the General Counsel of the Professional Managers Association (PMA), a non-profit membership association which represents Federal mid-level managers.

In my testimony today, I want to give you PMA's thoughts on the five specific issues involved in the design of a new civil service retirement plan for Federal employees hired since January 1, 1984 which are the focus of these hearings: (1) the cost of the system, (2) the social security "tilt," (3) employee contributions, (4) funding and financing, and (5) vesting.

Since PMA's testimony before this Committee March 13, 1984 on the development of a pension plan for new Federal employees, the study by Hay/Huggins Company and Hay Management Consultants on compensation in the Federal, state, and private sectors was released. That study showed that in total compensation (the total of cash compensation and fringe benefits) the Federal employee is 7.2 percent behind the private-sector employee on average and that it is expected that the 1985 update of this analysis will increase the advantage of private-sector total compensation to 9 percent or more. Moreover, since the study included small companies, the difference might be even greater if only the large private -sector employers with workforces similar to that of the Federal Government were studied. The study also showed that for employees at the $30,000 pay level the Civil Service Retirement System (CSRS) is 3 percent <u>less</u> valuable than the benefits provided by any of the top 10 percent of private-sector employers in the

study. Accordingly, with respect to the five issues to be discussed today, if the plan for new Federal employees were comparable to the better private-sector plans in the study, the plan for new Federal employees (1) would cost the Government 25.1 percent of pay -- actually a higher percent if the Federal tax subsidy were taken into account, as it should be -- compared with CSRS's cost to the Government of 24.7 percent of pay, (2) would recognize the Social Security "tilt," (3) would require no employee contributions except to Social Security, (4) would be fully funded, and (5) would not allow forfeiture of vested benefits attributable to employer contributions as the CSRS does when employees withdraw their own contributions.

I will now discuss the five specific issues.

1. Cost

The Congressional Research Service estimates the employer cost of the CSRS as 24.7 percent of pay. The top plans in the Hay/Huggins Company and Hay Management Consultants study cost the employers 25.1 percent of pay. Since, as was noted, normal cost estimates are extremely sensitive to changes in economic and demographic assumptions, we do not believe that normal cost estimates should determine the benefit package because one can argue that such actuarial measures of costs are not a reliable basis for making such decisions. Since, as the Congressional Research Service study on designing a retirement system for Federal workers covered by Social Security (December 1984) pointed out, covering Federal employees under Social Security will cost the Federal Government more to provide the same benefits that are provided under CSRS, cost is apparently not the most important issue. Moreover, we would like to point out that the Federal tax subsidy enjoyed by private-sector pension plans is not taken into account in the comparisons of the costs of those plans with the cost of CSRS. If it were, the costs of

private-sector pension plans would be considerably higher.

2. Social Security "Tilt"

Since Social Security replaces a higher proportion of earnings for low-wage employees, PMA believes this "tilt" should be taken into account in designing a pension for Federal employees who will be covered by Social Security. Whether the tilt is recognized through an "add on" or an "integrated" approach and whether the new plan takes the tilt into account 100 percent or at a lesser percent, PMA would like to emphasize that only that part of an employee's Social Security benefit attributable to Federal Service should be taken into account. That portion of an employee's Social Security benefit attributable to employment other than Federal service would not be taken into account. This is very important in order to avoid having short-service Federal employees losing most of their benefits from the Federal retirement plan.

3. Employee Contributions

Under CSRS employees pay 7 percent of pay to the retirement fund. Although private-sector employees contribute to Social Security for earnings up to a certain level, the majority of private-sector employees do not contribute to the private-sector pension plan. Unless the Congress wishes to further widen the existing disparaties in compensation between Federal employees and their private-sector counterparts, the total contribution required of Federal employees toward their retirement will certainly not be larger than the total 7 percent that is presently required.

4. Funding and Financing

All of the studies show that current financing methods will continue to provide adequate income to the CSRS fund. Moreover, it is not necessary for a Government retirement plan to be fully funded as a safeguard against bankruptcy or insolvency, prospects that cannot be overlooked in the private sector. The taxing power of the Federal Government provides the assurance that Federal retirement benefits can be paid. Consequently, there is not the necessity that a Government plan be fully funded as there is that a private-sector plan be fully funded.

Moreover, except for off-budget agencies, full funding of accruing retirement costs would not result in direct savings to the retirement system.

As to whether funding should come from agency appropriations or from the Treasury, with the exeption of off-budget agencies, there would be no effect on Federal receipts whether the funding comes from agency appropriations or the Treasury because there would simply be an internal transfer from one budget account to another.

However, if off-budget agencies, many of which have been established to operate on a self-supporting basis, were charged the full accruing retirement costs for their employees, their retirement contributions would increase, resulting in increased Federal revenues. The result would be additional CSRS fund income that would reduce annual costs to the Government.

5. Vesting

Federal employees are faced with serious loss of vested

benefit values if they quit their jobs before they are eligible to receive retirement benefits. No part of Federal pensions are portable as is Social Security. Moreover, unlike private-sector plans, where when benefits attributable to employer contributions are vested they are not forfeited when an employee quits before being eligible to receive a pension, Federal employees lose the vested benefits attributable to employer contributions when they withdraw their own contributions upon quitting their Federal jobs. Interest is not credited on such withdrawn employee contributions after 5 years of service as is required in the private sector for all employee contributions.

Most large private-sector defined benefit pension plans have 10-year cliff vesting. Many small private-sector pension plans are required by the Internal Revenue Service to have faster vesting, generally beginning at 4 years. Certain private-sector plans must have either 3-year cliff vesting or begin vesting after 2 years.

The Employee Retirement Income Security Act (ERISA) was enacted in 1974, 16 years after the passage of the Welfare and Pension Plans Disclosure Act. The purpose of ERISA was to impose minimum standards on private-sector pensions and to reduce unfair and inequitable practices and to assure employees that they would receive the pensions they were promised. Each year since ERISA's enactment ERISA has been amended to further reduce inequities. It will probably not be long before ERISA's vesting periods will be shortened by law. Over the years various bills proposed in Congress have required shorter vesting periods -- just as various bills have considered requiring private pension plans to provide cost of living adjustments to retirees.

The trend in employee benefits in the private sector over the years has been to increase and improve benefits, sometimes as a result of law and often for other reasons. Thus, with the passage of years, more and more plans have improved their benefit formulas, have lowered retirement age for unreduced benefits, have subsidized early retirement and survivor benefits, have shortened vesting periods, and provide post-retirement benefit increases to counteract the effects of inflation.

In concluding, PMA wishes to repeat its caution to the Committee, contained in our last year's testimony, that in the discussions of pension benefits for Federal employees, there are myths and misconceptions being stated and accepted as facts, and comparisons being made between apples and oranges, sometimes inadvertently and sometimes probably deliberately. As we said then, the pension field is a very complex one and we must be careful and precise in order not to come to erroneous conclusions.